43 Deducting Automobile Expenses

The costs of buying and operating a car for business are deductible under rules hedged with restrictions. The maximum depreciation deduction for a car placed in service in 1996 may not exceed $3,060, and this limit is reduced further by the percentage of your personal use. If you do not use your car more than 50% of the time for business, depreciation must be based on the straight-line method.

To avoid accounting for actual auto expenses and depreciation, you may claim an IRS mileage allowance of 31 cents per mile. Whatever choice you make, keep a record of business trip mileage.

If you are self-employed, you deduct your automobile expenses on Schedule C or Schedule C-EZ if eligible; *see* ¶40.5. Use Form 4562 to compute depreciation if you claim actual operating costs instead of the IRS mileage allowance. If you are an employee, use Form 2106 to claim unreimbursed automobile expenses, which are deductible only to the extent that together with other miscellaneous itemized deductions they exceed 2% of your adjusted gross income.

¶43.1 IRS Automobile Allowance

If you start to use your car for business in 1996, you have a choice of either deducting the actual operating costs of your car during business trips or deducting a flat IRS allowance of 31 cents per mile for all business mileage traveled during 1996.

If you placed a business car in service before 1996 and have always used the IRS mileage allowance, you may apply the 31 cents per mile rate to your 1996 business mileage or deduct your actual operating costs plus straight-line depreciation (assuming the car is not considered fully depreciated).

The mileage rate also applies to business trips in a van or pickup or panel truck as if it were a car.

The rate may not be used to deduct the costs of an automobile used for nonbusiness income-producing activities such as looking after investment property.

The choice of the allowance must be made in the first year you place an auto in service for business travel. If you do not use the allowance in the year you first use the car for business, you may not use the allowance for that car in any other year. Thus, if you bought a car for business in 1995 and on your 1995 return you deducted actual operating costs plus depreciation, you may not use the mileage allowance on your 1996 return or in any later year.

The allowance takes the place of fixed operating costs such as gasoline (including state and local taxes), oil, repairs, license tags, insurance, and depreciation. You may not take the allowance and deduct your actual outlays for these expenses. Parking fees and tolls during business trips are allowed in addition to the mileage allowance. The IRS will not disallow a deduction based on the allowance even though it exceeds your actual car costs.

EXAMPLE

You buy a car in 1996 and drive it on business trips. You keep a record of your business mileage. You traveled 20,000 miles on business. You may deduct $6,200 (20,000 × 31 cents). In addition, you spend $300 on tolls and parking. You may deduct a total of $6,500.

You may decide to use the allowance if you do not keep accurate records of operating costs. However, you must keep a record of your business trips, dates, customers or clients visited, business purpose of the trips, your total mileage during the year, and the number of miles traveled on business. An IRS agent may attempt to verify mileage by asking for repair bills near the beginning and end of the year if the bills note mileage readings.

Interest on a car loan and taxes. *See* ¶43.2 for when a deduction is allowed.

Mileage allowance disallowed. You may not claim the 31-cents-a-mile allowance if:

- You deducted actual operating costs in the first year you used the car for business.
- You have depreciated your car using the ACRS or MACRS method, including straight-line MACRS, or you claimed first-year expensing.
- You use in your business two or more cars simultaneously, such as in a fleet operation.
- You use your car for hire. That is, you use it as a taxicab, carrying passengers for a fare.
- You lease the car.

EXAMPLES

1. In 1996, you place in service a new auto costing $20,000 and use it only for business. You travel 20,000 miles on business trips. If you claim the allowance, your deduction is $6,200 (20,000 × 31 cents). If you claim actual costs, your depreciation deduction is limited to $3,060; *see* ¶43.3. To match the IRS allowance, you need actual operating costs (such as gas, oil, and maintenance) of at least $3,140. If these costs exceed $3,140, it is advisable to claim your actual expenses plus depreciation. Moreover, in 1997, you may deduct depreciation of up to $4,900 in addition to operating costs.

2. Same facts as in Example 1, but you travel only 9,600 business miles. If you elect the allowance, you may deduct only $2,976 (9,600 × 31 cents). If you elect to deduct actual costs, your depreciation deduction of $3,060 by itself exceeds the allowance. Assume your operating costs are $1,500. Your total deduction of $4,560 exceeds the allowance.

First-Year Election Affects Later Years

In deciding whether to elect the allowance in the first year, consider not only whether you will get a bigger first-year deduction using the allowance, or deducting actual operating costs plus depreciation, but also project your mileage, operating expenses, and depreciation expenses over the years you expect to use the car. If in the first year you elect to deduct actual costs, including accelerated MACRS or straight-line MACRS depreciation, you may not use the IRS auto allowance for *that car* in a later year. On the other hand, claiming the IRS allowance in the first year you put a car in service forfeits your privilege to use MACRS and first-year expensing. If you switch from the allowance to deducting actual expenses in later years, you may claim straight-line depreciation if the car is not considered fully depreciated.

If you use more than one automobile in your business travel and elect the allowance, total the business mileage traveled in both cars.

EXAMPLE

You use one car primarily for business and occasionally your spouse's car for business trips. During the taxable year, on business trips, you drove your car 10,000 miles and your spouse's car 2,000 miles. Total business mileage is 12,000 miles for purposes of the 31-cents-a-mile allowance.

Key to Deducting Automobile Expenses

Item—	*Tax Rule—*
IRS mileage allowance	You may avoid the trouble of keeping a record of actual auto expenses and calculating depreciation by electing the IRS mileage allowance of 31 cents a mile. The allowance may give you a larger deduction than your actual outlays plus depreciation. You must elect the allowance in the first year you use the car for business. If you do not, you may not use the allowance for that car in any other year.

If business mileage is—	*Your mileage allowance is—*	*If business mileage is—*	*Your mileage allowance is—*
5,000	$1,550	16,000	$4,960
7,500	2,325	17,000	5,270
10,000	3,100	18,000	5,580
11,000	3,410	19,000	5,890
12,000	3,720	20,000	6,200
13,000	4,030	22,000	6,820
14,000	4,340	25,000	7,750
15,000	4,650	30,000	9,300

To claim the allowance, you must be ready to prove business use of the auto and keep a record of your mileage. Of course, if your actual operating costs plus depreciation exceed the allowance, claim your actual operating expenses and depreciation.

Item—	*Tax Rule—*
Depreciation	If you claim actual operating expenses for a new car, such as gasoline, repairs, and insurance costs, you may also claim depreciation. There is a cap on the annual depreciation deduction. If you placed a car in service in 1996 your top deduction may not exceed $3,060. For a car placed in service in 1995, the 1996 maximum deduction is $4,900; for one placed in service in 1994, it is $2,850; for a car placed in service in 1993, it is $1,675; for a car placed in service in 1992 and 1991, $1,575; and for a car placed in service during the period from 1987 to 1990, the maximum deduction for 1996 is $1,475. For earlier year limits, *see* ¶43.4. These amounts are reduced if business use is less than 100%. Furthermore, accelerated MACRS or ACRS depreciation is allowed only for autos used more than 50% of the time for business driving. Where business driving is 50% or less, straight-line depreciation must be used. MACRS and ACRS depreciation deduction claimed in prior years may be recaptured if business use declines to 50% or less; *see* ¶43.9.
First-year expensing	If you claim actual costs for a new car, you may claim the first-year expensing deduction if it provides a larger deduction than allowed by depreciation under the MACRS rules of ¶43.5. For example, first-year expensing may give a larger deduction than depreciation if the cost of your auto is $15,300 or less, or if the mid-quarter convention applies. The first-year expensing rules are explained at ¶42.3. To claim first-year expensing, the auto must be used more than 50% for business travel. In 1996, the top deduction may not exceed $3,060. If business use is less than 100%, but more than 50%, the $3,060 limit is reduced. For example, if you use the auto 80% for business, the top deduction is $2,448 ($3,060 x 80%). If you elect first-year expensing in 1996, you may not use the IRS mileage allowance in later years for travel in that car. In 1997, you may claim MACRS depreciation, applying the second-year MACRS rate to your original basis reduced by the first-year deduction claimed in 1996; see ¶43.5.
Auto used for business and personal driving	You may deduct only the amount allocated to business mileage. For example, total mileage is 20,000 in 1996 and your business mileage is 15,000. You may claim only 75% of your deductible costs (15,000/20,000).
Tax return reporting	If you are an *employee*, you claim actual auto expenses or the IRS allowance on Form 2106. Form 2106 requires you to list mileage for business, commuting, and other personal trips. If your auto costs are not reimbursed by your employer, you must deduct them as miscellaneous deductions subject to the 2% AGI floor on Schedule A. If you are *self-employed,* you deduct business costs on Schedule C and use Form 4562 to compute depreciation if you claim actual operating costs. Costs deducted on Schedule C are not limited by the 2% adjusted gross income (AGI) floor.

Rural mail carriers allowed higher auto mileage rate. U.S. Postal Service mail carriers who use their cars to deliver and collect mail on rural routes may deduct a mileage rate equal to 150% of the basic rate. As the basic rate is 31 cents per mile, the special allowance is 46.5 cents per mile and applies to all rural delivery mileage.

Employer reimbursements. If your employer reimburses your auto costs at a rate lower than the IRS allowance, you may use the IRS rate to deduct the excess over your employer's reimbursement; *see* Example 3 at ¶20.33.

IRS allowance includes depreciation. When you use the IRS allowance, you may not claim a separate depreciation deduction. The IRS mileage allowance includes an estimate for depreciation. However, for purposes of figuring gain or loss on a disposition, you must reduce the basis of the car according to the following rates: 7 cents per business mile for 1980–1981; 7.5 cents per mile for 1982; 8 cents per mile for 1983, 1984, and 1985; 9 cents per mile for 1986; 10 cents per mile for 1987; 10.5 cents per mile for 1988; 11 cents per mile for 1989, 1990, and 1991; 11.5 cents per mile for 1992 and 1993; and 12 cents per mile for 1994, 1995, and 1996. For years before 1990, the annual cents-per-mile reduction applies only to the first 15,000 miles of business use per year for which the IRS allowance was claimed.

Depreciation when switching from allowance to actual costs. If you use the IRS mileage allowance in the first year, you may switch to the actual-cost method in a later year, but depreciation must be based on the straight-line method over the remaining estimated useful life. However, no depreciation may be claimed if basis has been reduced to zero under the annual cents-per-mile reduction rule just discussed.

¶43.2 Auto Expense Allocations

If you do not claim the IRS mileage allowance, you may deduct car expenses on business trips such as the cost of gas and oil (including state and local taxes), repairs, parking, and tolls.

If you use your car exclusively for business, all of your operating expenses are deductible. However, if you are an employee, the deduction is limited by the 2% adjusted gross income (AGI) floor; *see* ¶19.1.

Apportioning car expenses between business and personal use. For a car used for business and personal purposes, deduct only the depreciation and expenses allocated to your business use of the car. Depreciation is discussed at ¶43.3, ¶43.4, and ¶43.5.

The business portion of car expenses is determined by the percentage of mileage driven on business trips during the year.

EXAMPLE

In 1996, you drove your car 15,000 miles. Of this, 12,000 miles was on business trips. The percentage of business use is 80%:

$$\frac{\text{Business mileage}}{\text{Total mileage}} = \frac{12{,}000}{15{,}000} = 80\%$$

Your actual car expenses (gas, oil, repairs, etc.) for the year were $1,000, of which $800 ($1,000 × 80%) is deductible. If you are an employee, the $800 is deductible as a miscellaneous itemized deduction subject to the 2% AGI floor; *see* ¶19.1.

Interest on car loan. If you are an *employee*, all of the interest is considered personal interest and is not deductible even if you use the car 100% for your job. If you are *self-employed*, the allocated business percentage of the interest is fully deductible on Schedule C; the personal percentage is not deductible.

Taxes on purchase. Sales tax is not deductible whether you are an employee or self-employed; the tax is added to the basis of the auto for depreciation purposes; *see* ¶43.3. State and local property taxes are deductible as itemized deductions on Schedule A if you are an employee. If you are self-employed, deduct the business portion of the property taxes on Schedule C and the personal percentage on Schedule A if you itemize.

Leased car. If you lease a car for business use, you deduct the rental fee plus other costs of operating the car. If the car is also used for personal driving, the rental fee must be allocated between business and personal mileage. *See also* ¶43.11 for rules requiring the reporting of extra income attributable to the lease.

¶43.3 Auto Depreciation Restrictions

The law contains restrictions that limit and, in some cases, deny depreciation deductions for a business car. Employees may be unable to claim any deduction at all under an employer convenience test. Employees meeting that test and self-employed individuals must determine if they can use accelerated MACRS rates or must use straight-line rates. Finally, regardless of which depreciation method is used, the annual deduction may not exceed a ceiling set by law. For a car placed in service in 1996, the ceiling is $3,060; *see* ¶43.4 for details on the annual ceilings.

Employer convenience test. If you are an employee and use your own car for work, you must be ready to prove that you use a car for the *convenience of your employer* who requires you to use it in your job. If you do not meet this employer convenience test, you may not claim depreciation or first-year expensing. A letter from your employer stating you need the car for business will not meet this test.

The facts and circumstances of your use of the car may show that it is a condition of employment. For example, an inspector for a construction company uses his automobile to visit construction sites over a scattered area. The company reimburses him for his expenses. According to the IRS, the inspector's use of the car is for the convenience of the company and is a condition of the job. However, if a company car were available to the inspector, the use of his own car would not meet the condition of employment and convenience of the employer tests.

More-than-50% business-use test for claiming expensing or accelerated MACRS depreciation. An automobile is considered "listed property," as explained in ¶42.10, whether you are an employee or are self-employed. As such, you may claim first-year expensing (¶42.3) or accelerated MACRS (¶43.5) for a car placed in service during 1996 only if you use it in 1996 more than 50% of the time for business. The same annual ceiling applies to the expensing and MACRS deductions; *see* ¶43.4.

If business use is *50% or less* in the year the auto is placed in service, first-year expensing and accelerated MACRS are barred; the auto is depreciable over a six-year period under the straight-line method. Technically, the recovery period is five years but the period is extended to six years because, in the first year, a convention rule limits the deductible percentage. *See* the straight-line rate tables at ¶43.6. The straight-line method must also be used in future years, even if business use in those years exceeds 50%.

If a car is used for both business and investment purposes, only business use is considered in determining whether you meet the more than 50% business-use test and therefore qualify for MACRS. However, if your business use does exceed 50%, investment use is added to business use in determining your actual deduction.

EXAMPLE

Brown buys an automobile for $30,000 and places it in service in 1996. He uses it 40% for business and 20% for investment activity. Because he does not use his car more than 50% in his business, he may not claim first-year expensing or accelerated MACRS. He figures depreciation using the straight-line method. The business use allocation rate for depreciation is 60% (40% for business use plus 20% investment use).

Trucks and other vehicles. The more-than-50% business-use test generally applies to vehicles other than automobiles such as trucks, vans, boats, motorcycles, airplanes, and buses. However, the test does not apply to taxicabs and other vehicles used substantially all of the time to transport persons or property for hire. The test also does not apply to vehicles that are exempt from record-keeping requirements under ¶43.10 such as a school bus, dump truck, farm tractor or other specialized farm vehicle, delivery truck with seating only for the driver or with a folding jump seat, flat bed truck, garbage truck, passenger bus with capacity of at least 20, refrigerated truck, combine, specialized utility repair truck, unmarked law enforcement vehicle officially authorized for use, and a moving van if personal use is limited by the employer to travel from the employee's home to a move site.

A vehicle not in the exempt list is subject to the more-than-50% test for claiming accelerated MACRS depreciation or first-year expensing. If you do not satisfy the more-than-50% test, you must apply the straight-line recovery rates shown at ¶43.6.

Do your employees use the car? In certain cases, an employer who provides a company car to employees as part of their compensation may be unable to count the employee's use as qualified business use, thereby preventing the employer from meeting the more-than-50% business-use test for claiming MACRS. An employer is allowed to treat the employee's use as qualified business use only if: (1) the employee is not a relative and does not own more than 5% of the business; and (2) the employer treats the fair market value of the employee's personal use of the car as wage income and withholds tax on that amount. If such income is reported, all of the employee's use, including personal use, may be counted by an employer as qualified business use.

If an employee owning more than a 5% interest is allowed use of a company car as part of his or her compensation, the employer may not count that use as qualified business use, even if the personal use is reported as income. The same strict rule applies if the car is provided to a person who is related to the employer.

Recapture of MACRS Deductions

If you meet the more-than-50% test in the year the car or other vehicle is placed in service but business use falls to 50% or less in a later year, the recapture rules discussed at ¶43.9 apply.

¶43.4 Annual Ceilings on Depreciation

For cars placed in service after 1986, annual ceilings limit the amount of depreciation you may deduct. The ceilings apply both to self-employed individuals and employees. As a result of the ceilings, the actual write-off period for your car may be several years longer than the minimum recovery period of six years; *see* ¶43.5.

If the ceiling is less than the amount of depreciation figured under the regular MACRS rules, you are limited to the ceiling amount. For example, if in 1996 you bought a car for $20,000 which you used 100% for business, the regular MACRS rules would allow a deduction of $4,000 in 1996 (20% × $20,000), assuming the half-year convention applied; *see* ¶43.5. However, your 1996 depreciation deduction is limited to $3,060, the ceiling for cars placed in service during 1996. The ceiling is reduced if you use the car for both personal and business driving as discussed on the next page.

You may not exceed the ceiling by claiming first-year expensing (¶42.3). The $3,060 limit for cars placed in service in 1996 also applies to the first-year expensing deduction. Thus, the first-year expensing deduction in 1996 may not exceed $3,060. If you claim

first-year expensing of $3,060, you may not deduct any other depreciation. Claiming first-year expensing on Form 4562 (if self-employed) or Form 2106 (if an employee) may provide a larger deduction than regular MACRS depreciation where your deduction is subject to the mid-quarter convention; *see* ¶43.5.

The table below shows the year-by-year ceilings for cars placed in service between 1987 and 1996.

Personal driving reduces the annual ceiling. The annual ceilings are reduced if you use a car for both personal and business use. The reduced ceiling is equal to the regular ceiling multiplied by the percentage of business use. For example, in 1996, you buy a car costing $40,000. You use the car 70% for business travel. The MACRS deduction is limited to $2,142 ($3,060 × 70%). Furthermore, for purposes of figuring whether depreciation is allowed after the end of the recovery period, the basis of the car is reduced by the amount of the depreciation that would have been allowed if you had used the car 100% for business travel; *see* ¶43.7.

Ceilings for cars placed in service before 1987. The luxury car ceilings for cars placed in service after June 18, 1984, and before 1987, vary depending on when the car was placed in service.

For cars placed in service—	*Current ceiling—*
Before 6/19/84	None
After 6/18/84 and before 1985	$6,000
After 1984 and before 4/3/85	$6,200
After 4/2/85 and before 1987	$4,800

Light trucks and vans subject to the ceilings. The annual depreciation ceilings apply only to "passenger automobiles." For this purpose, a passenger automobile is generally considered to be any four-wheeled vehicle that is manufactured primarily for use on public streets, roads, and highways and that is weight-rated by the manufacturer at 6,000 pounds or less when unloaded (without passengers or cargo). However, a light truck or van that is weight-rated by the manufacturer at 6,000 pounds or less when loaded (gross vehicle weight) is treated as a passenger automobile.

The following are not considered "passenger" automobiles and thus are exempt from the annual ceilings: (1) an ambulance, hearse, or combination ambulance-hearse used directly in a business; and (2) a vehicle such as a taxicab used directly in the business of transporting persons or property for compensation or hire.

Sport utility vehicles. Owners of certain sport utility vehicles (SUVs)—the Chevrolet Suburban and Tahoe, the GMC Yukon, the Toyota Land Cruiser, the Lexus LX 450, all Land Rover models, the AM General Hummer, some versions of the Mitsubishi Montero, and the Ford Expedition—that are used for business purposes and that have a gross vehicle weight (loaded) of more than 6,000 pounds are not subject to the ceiling on depreciation deductions. This means the owner is entitled to the full depreciation deduction using the MACRS rate shown in ¶43.5.

SUV owners should check the manufacturers' specifications for their vehicles to see if the weight exceeds the 6,000 limit.

Annual Depreciation Ceiling for Cars Placed in Service After 1986

Ceiling	*For Auto Placed in Service in—*									
In—	*1987*	*1988*	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*	*1996*
1987	$2,560									
1988	4,100	$2,560								
1989	2,450	4,100	$2,660							
1990	1,475	2,450	4,200	$2,660						
1991	1,475	1,475	2,550	4,200	$2,660					
1992	1,475	1,475	1,475	2,550	4,300	$2,760				
1993	1,475	1,475	1,475	1,475	2,550	4,400	$2,860			
1994	1,475	1,475	1,475	1,475	1,575	2,650	4,600	$2,960		
1995	1,475	1,475	1,475	1,475	1,575	1,575	2,750	4,700	$3,060	
1996	**1,475**	**1,475**	**1,475**	**1,475**	**1,575**	**1,575**	**1,675**	**2,850**	**4,900**	**$3,060**
1997	1,475	1,475	1,475	1,475	1,575	1,575	1,675	1,675	2,950	4,900
1998	1,475	1,475	1,475	1,475	1,575	1,575	1,675	1,675	1,775	2,950
1999 ***and later years***	1,475	1,475	1,475	1,475	1,575	1,575	1,675	1,675	1,775	1,775

¶43.5 MACRS Rates for Cars

Business autos placed in service in 1987 and later years are technically in a five-year MACRS class (¶42.4), but because of the half-year or mid-quarter convention and the annual deduction ceilings, the minimum depreciation period is six years.

MACRS rate. To use accelerated MACRS or first-year expensing, you must meet the more-than-50% business-use test explained at ¶43.3. If you do, the MACRS rate is based on the 200% declining balance method with a switchover to straight line. The declining balance rate for a car that is five-year property is 40%. However, the full amount of the deduction is not allowed, because of the convention rules and the annual car limits discussed in this section. As explained in ¶42.5, each year the declining balance rate of 40% is applied against the declining balance of the basis of property.

As a shortcut, you may apply the half-year convention rates or the mid-quarter convention rates shown on this page and page 568, whichever applies in your case. The rates are applied against unadjusted basis, which is your cost minus any first-year expensing deduction. The deduction may not exceed the annual ceiling for auto depreciation, multiplied by the percentage of business use; *see* the Example in the next column.

Straight-line election for car if business use exceeds 50%. If business use of your car exceeds 50%, you may elect to write off your cost under the straight-line method instead of using the regular MACRS 200% declining balance method. The straight-line rates are shown in ¶43.6. The straight-line deduction is limited by the annual ceilings shown in ¶43.4. By electing straight-line depreciation, you avoid the recapture of excess MACRS deductions if business use drops to 50% or less in a later year; *see* ¶43.9. If the election is made, you must also use the straight-line method for all other five-year property placed in service during the same year as the car.

Electing 150% rate. The rates shown in this section for the half-year and mid-quarter convention are based on the 200% declining balance method. You may instead elect to apply a 150% declining balance rate. The 150% rate may be advantageous when you are subject to alternative minimum tax (AMT); *see* ¶42.8.

Half-year or mid-quarter convention. Regardless of the time of year you bought the car in 1996, your deduction is limited by a convention rule. If the only business equipment bought in 1996 was the car, then the half-year convention applies, unless you bought the car in the last quarter of 1996 (October, November, or December). Under the half-year convention, the car is treated as if it were placed in service in the middle of the year and the 40% declining balance rate is reduced to 20%. Use the table in the right column of this page to determine your deduction under the half-year convention.

If the only business equipment bought in 1996 was a car bought in the last quarter (October, November, or December), the mid-quarter convention applies. Under the table for mid-quarter convention rates on the next page, a 5% rate applies for fourth-quarter property, subject to the $3,060 deduction ceiling in 1996.

If you bought other business equipment in addition to the car, you must consider the total cost bases of property placed in service during the last quarter of 1996. If the total bases of such acquisitions (other than realty) exceed 40% of the total bases of all property placed in service during the year, then a mid-quarter rate applies to all property (other than realty). The mid-quarter rate for each asset then depends on the quarter the asset was placed in service. If the 40% test is not met, then the half-year convention applies to all the property acquisitions. As shown in the mid-quarter convention table on the next page, mid-quarter rates for each year of the recovery period depend on the quarter the property is placed in service.

MACRS Deduction: Half-Year Convention

Year—	Lower of percentage below or annual ceiling*—
1	20.00%
2	32.00
3	19.20
4	11.52
5	11.52
6	5.76

*The annual ceiling for the year depends on the year the car was placed in business service. For cars placed in service in 1996, the ceiling on 1996 returns is $3,060. The table on the previous page shows the ceiling for other years of service.

If your car is not used 100% for business in 1996, multiply the business-use percentage by the applicable ceiling and compare the result to the deduction figured by multiplying the business-use portion of the unadjusted basis (cost *minus* first-year expensing) of the car by the rate in the above table. Your deduction is the lower amount; *see the* Example below.

EXAMPLE

In May 1996, you place in service a car used 100% for business. The car cost $20,000. Here is the depreciation schedule assuming the car is kept for the period shown below and is used 100% for business trips:

1996	$3,060
1997	4,900
1998	2,950
1999	1,775
2000	1,775
2001	1,152
2002	1,775
2003	1,775
2004	838

Assume you use the car only 60% rather than 100% for business. You deduct $1,836 in 1996 (60% of the annual limit of $3,060). Your deduction may not be based on 60% of depreciable basis; this would give a larger deduction of $2,400 ($20,000 × 60% business use × 20% first-year depreciation rate) without considering the first-year deduction limit.

MACRS Deduction: Mid-Quarter Convention*

Year	Placed in service in— First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1	35.00%	25.00%	15.00%	5.00%
2	26.00	30.00	34.00	38.00
3	15.60	18.00	20.40	22.80
4	11.01	11.37	12.24	13.68
5	11.01	11.37	11.30	10.94
6	1.38	4.26	7.06	9.58

*If business use is 100%, you deduct the lower of the annual ceiling (*see* table on page 566) *and* the applicable mid-quarter rate multiplied by the unadjusted basis (cost less any first-year expensing deduction). If business use is less than 100%, multiply the lower amount by the business-use percentage to get the allowable deduction.

EXAMPLE

In November 1996, you buy a car for $23,000 that you use 100% for business. Applying the 5% rate for the fourth quarter from the table above, your deduction is $1,150 ($23,000 × 5%). This is less than the ceiling of $3,060.

If the car had been bought in May 1996, the 25% rate for the second quarter would give a deduction of $5,750 ($23,000 × 25%). However, your deduction would be limited to the $3,060 ceiling.

Mid-Quarter Rate Limitation

If the application of the mid-quarter convention limits your deduction to less than $3,060 for a car placed in service during 1996, consider an election to claim the first-year expensing deduction at ¶42.3 if your business-use percentage exceeds 50%. This may allow you to deduct up to $3,060, as in the following Example.

EXAMPLE

In December 1996, you place in service an auto used solely for business. It costs $25,000. Applying the fourth-quarter rate of 5% from the mid-quarter convention table above gives a depreciation deduction of only $1,250. If you elect first-year expensing, the deduction is $3,060.

Capital improvements. A capital improvement to a business auto is depreciable under MACRS in the year the improvement is made. The MACRS deductions for the improvement and auto are considered as a unit for applying the limits on the annual MACRS depreciation deduction.

Basis reduced by depreciation. The basis of a car is reduced by the *full* amount of depreciation that is allowable, whether or not a full deduction is actually claimed. For example, in 1996 you place in service a car costing $15,000, used 80% for business. Assuming the half-year convention applies, the unadjusted basis of the car is reduced by $3,060, the depreciation that would have been allowed in 1996 for 100% business use and not by the $2,448 depreciation deduction actually allowed (80% of business use × $3,060 maximum limit for 1996).

Converting a pleasure car to business use. The basis for depreciation is the lower of the market value of the car at the time of conversion and its adjusted basis, which is your original cost plus any substantial improvements and minus any deductible casualty losses or diesel fuel tax credit claimed for the car. In most cases, the value of the car will be lower than adjusted basis, and thus the value will be your depreciable basis. For a car converted to business use in 1996, the MACRS rate is applied to basis allocated to business travel. Unless you have mileage records for the entire year, you should base your business-use percentage on driving after the conversion. For example, in April 1996, you started to use your car for business and in the last nine months of the year you drove 10,000 miles, 8,000 of which were for business. This business percentage of 80% is multiplied by the fraction 9/12 (months used for business divided by 12) to give you a business-use percentage for the year of 60% (9/12 of 80%).

¶43.6 Straight-Line Rate for Business Use of 50% or Less

You may not use accelerated MACRS if your business use of your car is 50% or less. Mandatory straight-line recovery rates for business use of 50% or less using the half-year or mid-quarter convention are shown below. These straight-line rates are also used if you elect straight-line recovery (¶43.5) instead of the regular MACRS method. Because of the half-year convention, the straight-line recovery period is extended from five to six years.

The annual depreciation ceilings of ¶43.4 apply.

Straight-Line Year—	*Half-year Convention Rate—*
1	10%
2	20
3	20
4	20
5	20
6	10

EXAMPLE

In April 1996, you place in service an automobile which cost $15,000. You used it 40% for business. The depreciable basis is $6,000 (40% of $15,000). The depreciation deduction in 1996 is $600 (10% of $6,000) if the half-year convention applies.

If the mid-quarter convention applies (¶43.5), the depreciation deduction depends on the quarter the car was placed in service.

Straight-Line Mid-Quarter Convention*

Placed in service in—

Year	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1	17.50%	12.50%	7.50%	2.50%
2	20.00	20.00	20.00	20.00
3	20.00	20.00	20.00	20.00
4	20.00	20.00	20.00	20.00
5	20.00	20.00	20.00	20.00
6	2.50	7.50	12.50	17.50

* The deduction may not exceed the annual deduction ceiling; *see* page 566.

EXAMPLE

In 1996, you place in service a car costing $15,000 used 40% for business. Assume the mid-quarter convention applies. Depending on the applicable quarter, the deduction is listed below, figured on a basis of $6,000 ($15,000 × 40%). The first-year ceiling at 40% business use is $1,224 ($3,060 × 40%). The ceiling does not apply because the mid-quarter rates provide a lower deduction.

Quarter	*Deduction*
1	$1,050 ($6,000 × 17.5%)
2	750 ($6,000 × 12.5%)
3	450 ($6,000 × 7.5%)
4	150 ($6,000 × 2.5%)

¶43.7 Depreciation After Recovery Period Ends

If your business use of a car during the recovery period is 100% and your deductions are limited by the annual ceilings (¶43.4), any remaining basis that was not deducted because of the ceilings may be depreciated in the years after the end of the recovery period.

If the car was used less than 100% for business, any unrecovered basis may be deductible, but to determine unrecovered basis, original basis must be reduced by the depreciation that would have been allowed had the car been used 100% for business.

EXAMPLE

In 1990 you bought a car costing $28,600 which you used 100% for business every year from 1990 through 1995. Your depreciation deductions for the six-year recovery period were limited to a total of $13,835 by the annual ceilings. You deducted the ceiling amounts (*see* the table on page 566) of $2,660 in 1990, $4,200 in 1991, $2,550 in 1992, and $1,475 in each of 1993, 1994, and 1995, for a total of $13,835.

At the beginning of 1996, your unrecovered basis in the car is $14,765 (the original basis of $28,600 *minus* the $13,835 of depreciation deductions allowed from 1990 through 1995). If you continue to use the car 100% for business in 1996 and later years, you can deduct $1,475 in 1996 and also in later years until the $14,765 of unrecovered basis is used up.

If you had *not* used the car for business 100% of the time in all prior years, your unrecovered basis would still be $14,765. That is because for purposes of figuring unrecovered basis, you must reduce original basis by the depreciation that would have been allowed based on 100% business use. For years after 1995 in which business use is 100%, deductions of $1,475 are allowed until the unrecovered basis is used up. In years of partial business use, the deduction is limited to $1,475 multiplied by the business-use percentage.

¶43.8 Trade-in of Business Auto

No gain or loss is recognized on a trade-in of a business auto. Generally, the basis of the new auto is the adjusted basis of the old auto *plus* any additional payment. However, if you trade in an auto acquired after June 18, 1984, and it was not used solely for business, basis for figuring MACRS for the new auto is subject to a reduction. To find the basis of the new car, you start with the basis of the car that was traded in, add any cash paid on the trade-in, and reduce the total by the excess, if any, of (1) the total depreciation that would have been allowable if the old auto had been used solely for business or investment, over (2) the total of the depreciation actually allowed.

EXAMPLES

1. You traded in a car with an adjusted basis of $5,000 for a new car and, in addition, paid $8,000 cash for the new car. Both cars are used 100% for business. The unadjusted basis of the new car is $13,000 ($5,000 adjusted basis of the old car *plus* the $8,000 cash paid).
2. In 1994, you bought a car for $20,000 and used it 80% for business in 1994 and 1995. In January 1996, you traded it in for a new car and paid an additional $11,000.

   In 1994, you deducted MACRS depreciation of $2,368 (80% of $2,960 ceiling) and in 1995, $3,760 (80% of $4,700 ceiling). Your basis for purposes of figuring 1996 MACRS depreciation is $23,340, figured as follows:

Adjusted basis of old car	
Cost	$20,000
Less: depreciation for 1994 and 1995	6,128
Adjusted basis of old car	$13,872

Basis of new car	
Adjusted basis of old car	$13,872
Cash paid for new car	11,000
	$24,872
Less: depreciation adjustment*	1,532
Basis of new car	$23,340
*Depreciation adjustment for partial use:	
Depreciation if 100% business use	
1994	$2,960
1995	4,700
	$7,660
Less: actual depreciation	6,128
Adjustment	$1,532

¶43.9 Recapture of Deductions on Business Auto

If you use your car more than 50% for business in the year you place it in service, you may use MACRS accelerated rates; *see* ¶43.5. If business use drops to 50% or less in the second, third, fourth, fifth, or sixth year, earlier MACRS deductions must be recaptured and reported as ordinary income. In the year in which business use drops to 50% or less, you must recapture excess depreciation for all prior years. Excess depreciation is the difference between: (1) the MACRS deductions allowed in previous years, including the first-year expensing deduction, if any; and (2) the amount of depreciation that would have been allowed if you claimed straight-line depreciation based on a six-year recovery period. *See* ¶43.6 for straight-line rates.

The recapture rules do not apply if you elected straight-line recovery instead of applying accelerated MACRS rates.

Recapture is computed on Form 4797, which must be attached to Form 1040. The 50% business-use test and recapture rule applies to trucks and airplanes in addition to cars, but *see* the list of exceptions for taxicabs and other specialty vehicles at ¶43.3.

Any recaptured amount increases the basis of the property. To compute depreciation for the year in which business use drops to 50% or less and for later years within the six-year straight-line recovery period, you apply the straight-line rates shown at ¶43.6.

EXAMPLE

On June 25, 1993, you bought a car for $11,000 which you used exclusively for business in 1993, 1994, and 1995. During 1996, you used it 40% for business and 60% for personal purposes. In 1996, as you did not meet the more-than-50% business-use test, excess depreciation of $2,332 is recaptured and reported on Form 4797:

Total MACRS depreciation claimed (1993–1995)		$7,832
Total straight-line depreciation allowable:		
1993—10% of $11,000	$1,100	
1994—20% of $11,000	2,200	
1995—20% of $11,000	2,200	5,500
Excess depreciation recaptured		$2,332

Your 1996 depreciation deduction is $880 ($11,000 × 20% straight-line rate in fourth year × 40% business use).

The amount of recaptured depreciation increases the adjusted basis for purposes of computing gain or loss on a disposition of the automobile.

¶43.10 Keeping Records of Business Use

Keep a log or diary or similar record of the business use of a car. Record the purpose of the business trips and mileage covered for business travel. In the record book, also note the odometer reading for the beginning and end of the taxable year. You need this data to prove business use. If you do not keep written records of business mileage and your return is examined, you will have to convince an IRS agent of your business mileage through oral testimony. Without written evidence, you may be unable to convince an IRS agent that you use the car for business travel or that you meet the business use tests for claiming MACRS. You may also be subject to general negligence penalties for claiming deductions that you cannot prove you incurred.

Mileage records are not required for vehicles that are unlikely to be used for personal purposes, such as delivery trucks with seating only for the driver.

Employees using company cars are not required to keep mileage records if (1) a written company policy allows them to use the car for commuting and no other personal driving other than personal errands while commuting home, or (2) a written company policy bars all personal driving except for minor stops, such as for lunch, between business travel. Owners, directors, and officers of the company generally do not qualify for exception (1).

¶43.11 Leased Business Autos: Deductions and Income

If you lease rather than purchase a car for business use, you may deduct the lease charges as a business expense deduction if you use the car exclusively for business. If you also use the car for personal driving, you may deduct only the lease payments allocated to business travel. Also keep a record of business use; *see* ¶43.10.

Added income. If in 1996 you lease a car for 30 days or more, you may have to report as income an amount based on an IRS table. This income rule indirectly limits deductions of lease payments to the amounts that would be deductible as depreciation if you had bought the car outright. The income amount is reduced where you leased the car for less than the entire year or business use is less than 100%.

The lease tables, which are in IRS Publication 917, show income amounts for each year or the lease. Publication 917 also has tables showing income amounts for cars leased before 1996.